THE HONG KONG STOCK EXCHANGE (HKSE): A CAPITAL GATEWAY TO CHINA

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INTRODUCTION

In June 2015, barely a month after my arrival in Hong Kong, I met with Andrew Oates (at the time, Marketing Associate for the Hong Kong Shipowners' Association and Wah Kwong, now Business Development Manager at Marine Money Asia) and Arthur Bowring (Managing Director of the Hong Kong Shipowners' Association) to discuss a possible visit to Greece to promote the benefits of Hong Kong business opportunities for the Greek shipping community.

Unsurprisingly, debt financing and leasing were at the top of our list. It's no secret that a number of traditional Western shipping financiers have been facing difficulties in meeting the demand for financing projects since 2008. This is because of their exposure to the very expensive financings of the past, stringent capital adequacy requirements, and the current market volatility. Thus, in the early part of this decade, people turned their focus to Asian Export Credit financings and, most recently, to bilateral facilities with Chinese lenders as well as, of course, sale and leaseback transactions with Chinese lessors. The last of these is currently flavour of the month and seems to be gaining ground in the ship finance spectrum.

We then questioned if raising equity in a reputable Asian stock exchange, particularly on the Hong Kong Stock Exchange (HKSE), would appeal to Greek or other international shipowners as an alternative to NYSE, NASDAQ or Oslo.

WHY LIST IN HONG KONG?

Hong Kong is an international business and financial centre that attracts investors from around the world. Since the handover in 1997, it has played the role of "superconnector" between Mainland China and the rest of the world.

One appeal to international investors is that foreign companies use the city as their staging post for investing into China. That's because Hong Kong offers something that no mainland city does: a stable investment environment designed to be business friendly while aiming always to service free trade as well as benefitting from an independent common law system, protected by fair, transparent courts that enforce a long-established rule of law. While Hong Kong is part of China, it is a Special Administrative Region with a separate tax system offering particularly low tax rates (effectively 0% tax on international shipping outside of Hong Kong). Its culture is Asian with a Western influence, so both Western and Asian sensitivities and needs are understood.

It also has advantages as a location within Asia. Hong Kong is less than 5 hours flying time from 50% of the world's population, and is close to the major markets of China, Japan, Korea and South Asia. A number of international corporations have offices in Hong Kong to serve as platforms from which to conduct business in Asia.

Most international financial institutions have offices in Hong Kong, including the investment banks that played a key role in the frenzy of shipping IPOs on various stock exchanges during the "golden years" of 2004-2008. In addition, there are currently nine Chinese banks, several Chinese leasing houses, and four Chinese shipyard groups with offices in Hong Kong — and it is expected that more will emerge in 2016.

Hong Kong's stock exchange is the third largest in Asia (behind Tokyo and Shanghai (SSE)) and the fifth largest globally. In terms of capitalisation, it is growing rapidly. In fact, Hong Kong replaced New York this year as the biggest IPO market measured by funds raised which, in 2015, accounted for more than a third of total IPO proceeds for the entire Asia Pacific Region. So far, most predictions indicate that 2016 will be even stronger.

In addition to Hong Kong Financial Reporting Standards and International Financial Reporting Standards, HKSE also accepts the use of generally accepted accounting principles in the US (US GAAP) and other accounting standards used by new applicants on an exceptional basis. HKSE listing rules are comparable with international standards. A Hong Kong listing benefits from an advanced clearing and settlement infrastructure, allowing local financial institutions to settle US Dollar transactions real time in the Asian time zone against the delivery of Hong Kong Dollars. That beats waiting twelve hours for New York to open, leaving one exposed to greater foreign exchange settlement risks.

Hong Kong provides an ideal platform for issuers to gain exposure to the Mainland market. In the recent past, this was achieved indirectly through brokers or companies based in Hong Kong but, as of November 2014, the "Shanghai-Hong Kong Stock connect" initiative has enabled direct contact. The scheme aims to link up HKSE and SSE, allowing investors in either exchange to trade on both stock markets. Southbound investments are possible in companies that make up the Hang Seng Large Cap and Mid Cap indices (where strong shipping entities could be expected to trade in a reasonably healthy shipping market).

Some people controversially consider the HKSE to be China's real Stock Market, particularly after it admirably withstood the sudden sell down in the Chinese stock markets last summer. When IPOs ceased to be possible in the SSE following the market collapse, the HKSE proved stronger than ever and confirmed the view that Hong Kong offers the best listing platform from which to tap into China.

The benefits of a Hong Kong listing would not be limited solely to equity-raising opportunities. It would enable a Western shipowner to establish a presence in Asia — and presence is culturally important in this part of the world. A key difference between Asia and the West is the importance of relationship building prior to deal making. In the West, the relationship follows the contract while, in Asia, the contract follows the relationship. In the West, the contract is essential while, in Asia, the relationship is essential. Once the relationship is created, a Western shipowner could benefit in many ways: access debt financing opportunities which would normally only be available to an Asian shipowner (not only from Asian financiers but also from Western financiers acting through their Asian offices and who need to offer better pricing to maintain competitiveness in the region), establish relationships with Chinese leasing houses which now have a prominent presence in the ship-finance spectrum, establish relationships with shipowners, operators and charterers which could offer synergy or attractive ship employment opportunities, and consolidate existing relations with shipyards. Hong Kong can assist in the process of building relationships, not only within China but also within Asia.

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In terms of shipping IPOs, there are a number of reputable shipping companies currently listed in Hong Kong. Shipping and its different sectors are well understood in this part of the world, no less so than in other reputable business and financial centres such as New York or London.

WHAT TYPE OF INVESTMENT WOULD BE WORTH PRESENTING TO THE MARKET THROUGH HKSE?

There is no magic recipe to ensure success of a shipping IPO on HKSE or anywhere else. The same principles apply: a good track record, a great business model, top management and governance, and a competitive fleet cost would certainly be required. An investment based on solid foundations that has been planned, priced and budgeted properly and is not entirely speculative in nature could make an IPO on the HKSE appealing — particularly if the timing is right (think health of the equity markets and shipping cycle). The same principles that apply in other reputable stock exchanges apply in Hong Kong. However, projects containing an Asian element — particularly a Chinese element — would make an HKSE listing more appealing. For example: the issuer owning vessels which are chartered out on a long-term basis to reputable Asian charterers, or the issuer's board of directors comprising reputable, experienced and successful Asian shipping personalities, or the issuer's stock being held by one or more cornerstone Asian shipowner investors.

The last of the three scenarios may be the most relevant and could necessitate a listing in Asia. We have recently seen a number of joint ventures between Asian and Western shipowners. We have also seen an increased interest in China in the formation of synergies with reputable international players. In fact, it wouldn't be surprising if, in the coming years, Chinese-controlled or Asian-located multinational funds, leasing houses and other financial institutions with distressed assets to "play with" enter such synergic alliances. These could to some extent substitute the US-controlled private equity funds as a source of equity, considering the losses that US PE has recently suffered through endemic investment in shipping. The approach would be less opportunistic, so projects would best be founded on a long-term strategy to minimise the risks of shipping's cyclical nature.

For example, an investment in LNG/LPG vessels, container vessels, tankers chartered out on long-term basis to oil majors, or even investments around the acquisition of bulk carriers bought at historically low prices and chartered out (at least the majority of such vessels) to reputable charterers on a long-term basis when, hopefully, the market rises, could be more appealing to Asian investors. If growth forms part of the investment strategy, then an IPO would appear logical. We should also not forget that access to the capital markets provides an easy exit route for investors, and this would be no exception to Chinese investors for whom the HKSE would provide the requisite liquidity.

CONCLUSION

This year's forecast for most shipping sectors is rather gloomy, but times of despair for some are times of opportunity for others. At the moment, capital markets are not particularly keen on shipping IPOs. The share price of a number of listed shipping companies in New York has reached rock bottom, and it is now common knowledge that the shipping investments of most private equity funds have not turned out to be as profitable as originally expected. Consequently, new shipping IPOs on NASDAQ or NYSE may not be possible or worthwhile in the foreseeable future.

This article does not aim to reinvent the wheel, but seeks to shed some light on possible advantages and opportunities that HKSE could offer potential new issuers in a more open Chinese economy. Hong Kong is China's gateway, an internationally recognised financial centre with an abundance of professional expertise strategically placed in a growth region. If you also consider the recent willingness of Chinese equity providers to form alliances with reputable shipowners for solid shipping projects, it makes sense to consider HKSE as an alternative platform for raising equity and forming further strategic alliances.

At Watson Farley and Williams, we strongly believe in this market — hence the firm's rapid growth in the region — and would be delighted to assist in any such pioneering project. We would be particularly excited to see the Greek shipping community pursue such synergies and capital market opportunities, as we believe the Greek-Asian axis will become stronger and increasingly influential. With a strong presence in both Greece and Asia, we are very well prepared to facilitate such a scenario. It would not be the first time that members of the Greek shipping community pioneer on this front, as they did admirably in the 1990s and then in the "golden era" of the 2000s. Maybe it is time they do so again, only this time on the other side of the world. Watch this space.